EFRAG
European Financial Reporting Advisory Group

EFRAG TEG meeting
5 – 6 November 2019
Paper 10-02
EFRAG Secretariat: Goodwill and Impairment Team

IASB Research project - Goodwill and Impairment Relief from mandatory impairment test and amortisation of goodwill

Issues paper

Objective

1 The purpose of this paper is to seek views from EFRAG TEG members on the IASB tentative decisions on its Research project on Goodwill and Impairment (the project) in relation to:

(a) Relief from the mandatory impairment test; and

(b) Amortisation of goodwill.

Relief from mandatory impairment test – goodwill and some intangibles

2 After concluding that it would not be possible to make the impairment test significantly more effective, the IASB decided to refocus the objectives of the project.

3 One of the objectives is to pursue simplifying the subsequent accounting for goodwill by exploring possible relief from the requirement to carry out a mandatory annual quantitative impairment test of CGUs that include goodwill, as required under IAS 36 *Impairment of Assets*. The same relief would be provided for intangible assets with indefinite useful lives and intangible assets not yet available for use.

Indicator only approach

4 The IASB discussed an indicator-based model for goodwill impairment at its meeting in May 2019, but took no decisions at that meeting.

5 During its June 2019 meeting, the IASB tentatively decided to:

(a) remove the requirement to carry out an annual quantitative impairment test for goodwill when no indicator of impairment exists; and

(b) for intangible assets with indefinite useful lives, and for intangible assets not yet available for use, apply the same relief as for goodwill.

6 Eight of 14 IASB members agreed and six disagreed with this decision.

7 In the feedback from the Post Implementation Review of IFRS 3 *Business Combinations* (PIR), many stakeholders commented that the annual quantitative impairment test of goodwill required under IAS 36 is costly and complex to implement, and any resulting recognition of impairment losses is often late and inadequate. These comments were further supported by the research during this project. Other stakeholders suggested that the IASB should require a quantitative impairment test only if indicators of impairment exist.

8 To address the above concerns the IASB considered four indicator-based impairment approaches with different frequencies of impairment tests as potential replacements for the existing impairment model.

(a) *Approach 1* - the IASB could require an entity to perform a quantitative impairment test of goodwill in the first year after a business combination; and

in subsequent years perform the quantitative impairment test only when there are indicators of possible impairment;

(b) *Approach 2* - the IASB could require an entity to perform a quantitative impairment test of goodwill at least annually (and more frequently whenever there are indicators of possible impairment) for the first few years after a business combination, perhaps 3–5 years; and in subsequent years perform a quantitative impairment test only when there are indicators of possible impairment;

(c) *Approach 3* - the IASB could require an entity to perform a quantitative test of goodwill less frequently than annually, for example once every 3 years; and in the intervening periods perform a quantitative impairment test only when there are indicators of possible impairment; and

(d) *Approach 4* - the IASB could require an entity to perform a quantitative impairment test of goodwill only when there are indicators of possible impairment.

9 The IASB also considered an optional qualitative test, similar to an option allowed under US GAAP (referred to as 'Step Zero').

10 The IASB staff recommended Approach 4. The IASB staff considered that an indicator-only model could save costs for preparers and allow entities to apply the same impairment test for all Cash-generating Units (CGUs), regardless of whether they contain goodwill or some identifiable intangible assets. The IASB agreed.

Pros and cons of an indicator-only approach

11 Benefits of such an approach, identified by the IASB, would be that:

(a) it would remove complexity and help to improve consistency within IAS 36;

(b) cost savings for preparers by reducing frequency of the test; and

(c) application of the same impairment test for all CGUs, regardless of whether they contain goodwill or some identifiable intangible assets.

12 On the other hand, such an approach could:

(a) make the impairment test marginally less robust, especially if the amortisation of goodwill is not reintroduced and because of the greater management judgement involved;

(b) result in some limited loss of information that users of financial statements might find useful, such as the discount rates, long-term growth rates, profit and capital expenditure assumptions and sensitivities used in the quantitative impairment test; and

(c) slightly weaken governance over goodwill impairment test.

13 An indicator-only model would require greater management judgement and entities could potentially behave opportunistically to avoid recognising an impairment loss on goodwill. However, there is some evidence in the US that entities are not using the optional test in US GAAP opportunistically. [1]

14 The IASB observed that given that the objectives of both the indicator-only approach and the optional qualitative test in US GAAP are to avoid imposing a quantitative test when it would not result in an impairment test, it is not necessary to create a new impairment model within the framework of IAS 36 by adopting the optional qualitative test for CGU's containing goodwill.

---

[1] Duff & Phelps (2017). 2017 US Goodwill Impairment Study.

15 The delayed recognition of goodwill impairment is due to factors other than the frequency of the impairment test, and hence cannot be mitigated by performing the test more frequently than annually. Therefore, the IASB considered that the adoption of an indicator-only approach would not significantly reduce the robustness of the test.

16 On balance, the IASB considered that providing entities with relief from the mandatory annual impairment test for goodwill could result in cost-savings for preparers and in a uniform impairment model in IAS 36. This would help to achieve the objective of simplifying the accounting for goodwill.

17 For similar reasons the IASB decided to extend this relief to intangible assets with indefinite useful lives and intangible assets not yet available for use. In the IASB's view this approach will:

(a) remove the difference in frequency of impairment tests between identifiable and unidentifiable intangible assets (including goodwill);

(b) reduce scope for accounting arbitrage when different impairment models applied to goodwill and other types of intangible assets; and

(c) ensure the consistent accounting treatment between intangible assets not yet available for use and tangible fixed assets under development (no mandatory impairment test for both categories).

Potential indicators of impairment

18 The IASB also highlighted the importance of having a robust set of indicators for an indicator-only impairment model. Paragraph 12 of IAS 36 already sets out a non-exhaustive list of indicators. This list includes external and internal sources of information that an entity should consider in assessing whether an asset is impaired such as declines in the value of the asset, significant changes in the environment in which the entity operates that might adversely affect the value of the asset, entity's market cap and evidence from internal factors that point to a potential decline in the value of the asset.

19 The possible additions might include:

(a) a failure to meet the key objectives of the acquisition;

(b) indicators of impairment suggested or used by other bodies, such as EFRAG and the FASB. They include macroeconomic and entity specific conditions, such as observable prices for CGU, evolution of entity actual earnings vs budget, cost factors, changes in management, etc.

20 EFRAG, in its Discussion Paper *Goodwill Impairment Test: can it be Improved?* (EFRAG DP) discussed the 'Step Zero' approach under US GAAP as a possible solution and potential indicators of impairment that could be considered. Appendix 1 provides a summary of these indicators.

FASB Consultation on Identifiable Intangible Assets and Subsequent Accounting for Goodwill – amortisation period

21 In July 2019, the FASB published an Invitation to Comment (ITC) on Identifiable Intangible Assets and Subsequent Accounting for Goodwill with comments requested by 7 October 2019. The FASB seeks feedback on (1) amortising goodwill and (2) modifying the goodwill impairment test.

22 In its ITC, the FASB discusses the possibility to remove the requirement to assess goodwill at least annually and only require that an entity assesses goodwill for impairment following an event or change in circumstances that indicates that goodwill may be impaired (that is, following a "triggering event"). However, it notes that some stakeholders suggested that removing the requirement to assess goodwill for impairment at least annually would be appropriate only if coupled with goodwill

amortisation because amortisation likely would reduce the need to impair goodwill. The FASB is seeking stakeholders' views on the extent to which they support (or oppose) removing the requirement to assess goodwill (qualitatively or quantitatively) for impairment at least annually.

EFRAG TEG-CFSS and ASAF discussions

23 EFRAG TEG-CFSS[2] and subsequent ASAF discussions did not specifically address the removal of the mandatory impairment test, mainly because the IASB had tentatively decided in December 2017 not to propose providing entities with relief from the mandatory annual quantitative impairment testing for goodwill, and instead to focus on improving the effectiveness of goodwill impairment test.

EFRAG User Panel

24 The EFRAG User Panel expressed mixed views on the indicator-only approach at its meeting in July 2019.

(a) Some members supported the indicator-only impairment model with a robust list of indicators. One member noted that whether acquisitions were living up to expectations could be determined from other available information. However, another member thought that this relied on the disclosures required by the IASB to obtain the right information to reveal impairments.

(b) Other members highlighted that goodwill impairment had been recognised too little and too late. Without annual impairments, they did not think the problem would be solved.

EFRAG Academic Panel

25 At its meeting on 18 October 2019 Academic Panel members had mixed views. Some members indicated that the indicator approach could reduce the complexity and could save cost for preparers while other members commented that an indicator approach could not resolve the 'too little too late' impairment issue. However, the overall majority generally supported the indicator approach combined with amortisation.

Amortisation of goodwill

26 At its meeting in June 2019, the IASB also considered whether it should reintroduce amortisation of goodwill in order to reflect the consumption of acquired goodwill in the financial statements.

27 In its analysis, the IASB staff concluded that neither the impairment-only model nor the amortisation approach produces a perfect answer and stakeholder preferences will depend on which arguments they give more weight to. For instance, some will argue that the impairment-only model risks mislabelling consumption as impairment losses; while others will argue that amortisation risks pre-empting impairment losses and mislabelling them as consumption. Overall, the IASB staff concluded that a desire to reduce the carrying amount of goodwill is not strong enough to reintroduce amortisation.

28 There were mixed views from IASB members on this point, with only a slight majority (8/14) not supporting the reintroduction of amortisation of goodwill. Given the mixed views, the forthcoming IASB discussion paper is likely to discuss whether goodwill should be amortised.

[2] EFRAG TEG-CFSS discussed the project at its meetings in March 2019, November 2018, July 2018 and March 2018).

FASB Consultation on Identifiable Intangible Assets and Subsequent Accounting for Goodwill – amortisation period

29 In its ITC, the FASB discusses the following approaches to determining the goodwill amortisation period:

(a) A default period;

(b) A cap (or maximum) on the amortisation period;

(c) A floor (or minimum) on the amortisation period;

(d) Justification of an alternative amortisation period other than a default period;

(e) Amortisation based on the useful life of the primary identifiable asset acquired;

(f) Amortisation based on the weighted-average useful lives of identifiable asset(s) acquired;

(g) Management's reasonable estimate (based on expected synergies or cash flows as a result of the business combination, the useful life of acquired processes, or other management judgments).

30 The ITC notes that the FASB had received mixed feedback on whether it is appropriate to amortise goodwill over a default period. Some stakeholders indicated that a default period is the most effective way to reduce costs for entities.

31 However, other stakeholders opposed a default period for a variety of reasons. One reason mentioned in the ITC is that stakeholders would benefit from an amortisation period that attempts to convey some information about the expected period of benefit. That specific information about the amortisation period may be of more importance to equity investors (which are more prevalent with PBEs) as compared with creditors (which are more prevalent with non-PBEs).

32 The ITC also notes the lack of common agreement on a 'default period', with some stakeholders supporting a period shorter than 10 years and others supporting a period longer than 10 years.

33 Some stakeholders indicated that goodwill is more relevant in the periods immediately following a business combination. However, opponents noted that a shorter amortisation period could conceal underperforming acquisitions. This is one reason users consistently expressed significant concern about the immediate write-off of goodwill, which is the amortisation period taken to its shortest extreme.

34 In the ITC, the FASB asked stakeholders:

(a) If their views on amortisation versus impairment of goodwill would depend on the amortisation method and/or period; and

(b) Whether equity investors would receive decision-useful information when an entity justifies an amortisation period other than a default period and whether the benefit of this information justifies the cost.

EFRAG TEG-CFSS and ASAF discussions

35 At its meeting in November 2018, EFRAG TEG-CFSS discussed whether amortisation of goodwill should be reintroduced. There was broad support for the IASB to consult on the reintroduction of amortisation of goodwill and to explore ways to determine an amortisation period that could reflect the consumption of economics benefits arising from acquired goodwill.

36 Members discussed some possible amortisation approaches, but generally acknowledged that the amortisation period would be a significant challenge. Members understood the request from users for improved disclosure on the rationale of a business combination and its subsequent success but noted the need to examine how this could be achieved.

EFRAG User Panel

37 At its meeting in July 2019, the EFRAG User Panel expressed mixed views on whether goodwill should be amortised.

EFRAG Academic Panel

38 At its meeting in October 2019, there was a general tendency from Academic Panel members to suggest it was worth exploring amortisation of goodwill especially in combination with an indicator-only approach. Members suggested that amortisation should not replace an impairment test.

Questions for EFRAG TEG members

39 What are your views on the IASB's tentative decision to remove the requirement to carry out an annual quantitative impairment test for goodwill when no indicator of impairment exists?

40 If the annual impairment test is replaced with an indicator-only approach, do you think amortisation of goodwill should be reintroduced? If so, please explain why.

41 Do you consider that the IASB should provide a more comprehensive list of impairment indicators? If so, what indicators would you consider to be critical?

42 What are your views on the IASB's tentative decision to apply the same relief as for goodwill for intangible assets with indefinite useful lives, and for intangible assets not yet available for use?

43 At this stage do you have any views on the amortisation periods discussed in the FASB's ITC in paragraph 29?

Appendix 1 – Potential indicators of impairment that the IASB could consider (indicated in the IASB agenda paper 18D discussed at the IASB meeting in June 2019)

Indicators of impairment suggested in the EFRAG DP

1 The introduction of a Step Zero would require more specific and adapted indicators for goodwill, which would build on those in IAS 36. In evaluating whether or not the likelihood of an impairment is remote, an entity would have to assess relevant events and circumstances that could include the following:

(a) Macroeconomic conditions:

(i) a decline in general of economic conditions (eg equity and credit markets) or limitations on accessing capital;

(ii) industry and market considerations such as a deterioration in the environment in which an entity operates or increased competitive environment; and

(iii) cost factors such as significant increases in raw materials, labour, or other costs that have a negative effect on earnings and cash flows.

(b) Conditions specific to the entity/CGU:

(i) observable prices for the CGU, such as prices paid by the acquirer or a third party to buy a non-controlling interest, vesting or non-vesting of performance-based options on non-controlling interest and the outcome of contingent consideration clauses;

(ii) significant decline in actual and planned earnings when compared with prior projections;

(iii) whether the reasons for undertaking the business combination have been met, for example in relation to expected technological innovation, access to markets or realisation of expected synergies from the combination;

(iv) information from previous impairment calculations, such as whether the most recent calculations have indicated that the recoverable amount of the CGU is significantly greater than its carrying amount and assets and liabilities composing the CGU have not changed significantly since then;

(v) changes in the way the acquired business is managed or changes in plans, such as restructuring or discontinued operations of the business acquired;

(vi) restructuring costs are significantly higher than initially expected; and

(vii) other relevant entity-specific events such as changes in key personnel or customers, contemplation of bankruptcy or litigation.

Indicators of impairment used in FASB's optional qualitative assessment (Paragraph 350-20-35-3C in the FASB Accounting Standards Codification)

2 In evaluating whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, an entity shall assess relevant events and circumstances. Examples of such events and circumstances include the following:

(a) Macroeconomic conditions such as a deterioration in general economic conditions, limitations on accessing capital, fluctuations in foreign exchange rates, or other developments in equity and credit markets.

(b) Industry and market considerations such as a deterioration in the environment in which an entity operates, an increased competitive environment, a decline in market-dependent multiples or metrics (consider in both absolute terms and relative to peers), a change in the market for an entity's products or services, or a regulatory or political development.

(c) Cost factors such as increases in raw materials, labour, or other costs that have a negative effect on earnings and cash flows.

(d) Overall financial performance such as negative or declining cash flows or a decline in actual or planned revenue or earnings compared with actual and projected results of relevant prior periods.

(e) Other relevant entity-specific events such as changes in management, key personnel, strategy, or customers; contemplation of bankruptcy; or litigation.

(f) Events affecting a reporting unit such as a change in the composition or carrying amount of its net assets, a more-likely-than-not expectation of selling or disposing of all, or a portion, of a reporting unit, the testing for recoverability of a significant asset group within a reporting unit, or recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit.

(g) If applicable, a sustained decrease in share price (consider in both absolute terms and relative to peers).